

4-1-1928

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Recommended Citation

Gustavus H. Robinson, *Duty of a Public Utility to Serve at Reasonable Rates: The Valuation War*, 6 N.C. L. REV. 243 (1928).Available at: <http://scholarship.law.unc.edu/nclr/vol6/iss3/2>

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DUTY OF A PUBLIC UTILITY TO SERVE AT REASONABLE RATES: THE "VALUATION" WAR

GUSTAVUS H. ROBINSON*

The obligations which Society lays upon enterprises which it impresses with public utility status have been variantly emphasized at different times. After a long battle for equality treatment of utility users, we have begun, in recent years, another contest for the enforcement of the requirement that the utility's service shall be at reasonable rates. If, in the legal war against discrimination, the reasonable rate for all had been found in the figure which the utility charged its most favored customer,¹ a rough—and thoroughly unsatisfactory—answer might have been had, thereby, for the question "what is a reasonable rate"? It is, of course, a matter of history that the campaign for equality treatment ended in a publicly prescribed figure which serves as a common denominator for charges as between customers. This, however, leaves the authority which prescribes or sanctions the charge faced with the duty of finding a rate which, when set, will not only satisfy for equality as between users A and B, but which will suffice as between the utility itself on the one side, and the customers on the other; of fixing a figure to serve not only as a basis for nondiscrimination, but which also shall serve as a reasonable rate to the utility as well. It has been stated that "there is a difference between a rate which is merely non-confiscatory and one which is just and reasonable," and "it is the just and reasonable rate which the commission is called upon to fix."² But

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¹ There was some tendency to accept this. See the discussion in *Sullivan v. Minneapolis and R. R. Co.* (1913), 121 Minn. 488, 142 N. W. 3; 45 L. R. A., N. S. 612, and *Seaman v. Minn. I. R. R. Co.*, 127 Minn. 180 (1914), 149 N. W. 134; also Stone, Cir. J.'s, dissent in *Homestead Co. v. Des Moines Elec. Co.*, 248 Fed. 439 (1918); 12 A. L. R. 390.

See B. M. Kline, "The origin of the rule against unjust discrimination" 66 U. P. L. R. 123 (1918); and "The scope of the rule against unjust discrimination" 67 U. P. L. R. 109 (1919).

² *State Public Utility Comm. v. Springfield Gas and Elec. Co.* 291 Illinois 209 (1920), 125 N. E. 891.

"the tendency developed to fix as reasonable the rate which is not so low as to be confiscatory."³

"What is a reasonable rate?" is a two-fold question, even from the utility's angle. What should it charge John Smith, for a single service, if it is a utility which is doing different kinds of service in different degrees? What should it ask him per basket for peaches from town A to town B if it is a road which carries every sort of commodity, including the human package—passengers—among all the towns of the alphabet? The costs of the service it renders Smith, whether current expenditures or overhead, are large constants and must be more or less arbitrarily apportioned to his peaches. Because classification, rather than mere bulk or weight, has become one of the rock bottom acceptances, some more or less rationalizable assignment of peaches to a class must be made, and a rate, for the class, fixed. The particular peaches rate therefore has, perforce, become a matter of economic realism; and is left largely to the commissions as peculiarly within the administrative field. Its judicial handling has been far from satisfactory.⁴

The other aspect of the reasonable rate question, namely, what shall all the users of the utility pay for the utility's total service, is the phase of the general problem bulking large in current litigation and in present literature legal, economic, and financial. Vast political and vast ulterior economic possibilities lie in it.⁵ In a famous case⁶

³ Mr. Justice Brandeis in *South Western Bell Tel. Co. v. Public Service Commission*, 262 U. S. 276 (1923), 43 S. Ct. 544, 67 L. Ed. 981, 31 A. L. R. 807, says "The rule there (in *Smyth v. Ames*, 169 U. S. 466, 1898) stated was to be applied solely as a means of determining whether rates already prescribed by the legislature were confiscatory. It was to be applied judicially after the rate had been made, and by a court which had no part in making the rate. When applied under such circumstances the rule, although cumbersome, may occasionally be effective in destroying an obstruction to justice, as the action of a court is when it sets aside the verdict of a jury. But the commissions undertook to make the rule their standard for constructive action. They used it as a guide for making, or approving rates. And the tendency developed to fix as reasonable, the rate which is not so low as to be confiscatory. Thus, the rule which assumes that rates of utilities will ordinarily be higher than the minimum required by the Constitution has, by the practice of the commissions, eliminated the margin between a reasonable rate and a merely compensatory rate," p. 296, in 262 U. S.

⁴ *Northern Pacific Ry. Co. v. North Dakota*, 236 U. S. 585 (1915). In "Non Cost Standards in Rate Making," 36 Yale L. J. 56 (Dec. 1926). Mr. Robert L. Hale, whose name in the reasonable rate field spells authority, discusses "the serious qualifications to the (case's) doctrine that each class of rates must pay its own cost plus a fair return." See also a note in 25 Harv. L. Rev. 276 (1911) on the economics of rates on bulky low grade commodities.

⁵ The railroad situation speaks for itself. The Walsh Resolution for the investigation of interstate purveyors of power, light, gas, which the Senate

Mr. Justice Brandeis states the thesis: "The investor agrees, by embarking capital in a utility, that its charges to the public shall be reasonable. His company is the substitute for the state in the performance of the public service, thus becoming a public servant. The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business. Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital." Discussion groups itself around the headings he thus indicates. The article which follows is designed to be purely expository of the recent developments in these particular phases of the rate problem.

(a) OPERATING EXPENSES

If a public which uses the facilities of a utility is to be asked to pay operating expenses as an obviously primary charge on the rate income, the inevitableness of public scrutiny of the accounts is manifest. It is an obvious commission task.

In this matter the Interstate Commerce Commission recently encountered what might be called the invitation to padding which the recapture policy of the 1920 Act holds forth. In the *O'Fallon Railway Case*,⁷ a recapture litigation which bids fair to be a landmark in rate base valuation,⁸ the closely allied O'Fallon and Manufacturer's Companies had, respectively, nine miles and five miles of main line and twelve and twenty-five miles of yard track. As the roads were part of the car-distributing facilities of the St. Louis environs, however, it is only fair to say that they were more significant than the mere mileage would indicate. Yet the Commission felt that their importance did not justify the salaries they paid at the top. In 1916 the president (of both) drew \$6,000 a year from each; in 1920 he was voted \$4,000 more as president of the O'Fallon, a total of \$16,000; and in 1923 he was voted, and subsequently paid, \$25,000 for services in securing from another road a larger division

adopted, Feb. 16, 1928, and committed to the Federal Trade Commission opens new vistas.

⁷ The South Western Bell Tel. Case, ante Note 3, at p. 304.

⁸ Excess income of St. Louis and O'Fallon Ry. Co. Excess income of Manufacturer's Ry. Co., 124 I. C. C. 3, Feb. 15, 1927.

⁹ The approach to valuation has been, in general, from the angle of rate regulation.

of joint rates. The stock of both roads was largely owned by the Busch family, one of whom, as chairman of the board, had drawn \$4,800, from both, since 1916. In 1923 he was voted \$18,000 a year (\$15,000 O'Fallon, \$3,000 Manufacturers). Thus the high-up overhead for salaries became \$34,000 per year.

The Commission found no justification for the bonus to the president, nor did it find any increase of labor on the part of the chairman; and it said, p. 16:

"In view of the fact that the statute, as was recognized by the Supreme Court in the above quotation,⁹ makes the excess earned by an interstate railroad over a fair return on the value of its property a trust fund for the United States, we think it improper for the O'Fallon to have diverted to 'operating expenses' the portion of such trust fund represented by the increased compensation to the president and the chairman of the board of directors. Such radical increases in compensation for these positions, over what had been paid for many previous years, require other justification than the mere availability of funds, which is, upon analysis, substantially the only justification offered of record. We are without authority to direct the actual disposition of income of carriers, but in our computation of the amount of net railway operating income for the recapture periods we shall not include as charges to operating expenses the increases in compensation to the president and chairman of the board of directors of the O'Fallon during 1923."

The cost and the burden upon public utilities of litigation arising out of regulation is one of the standing reproaches to our ingenuity,¹⁰

⁹ *Dayton Goose Creek Ry. Co. v. U. S.*, 263 U. S. 456 (1924) was the case quoted. It sustained the recapture provisions of the 1920 act. See C. W. Bunn, "The Recapture of Earnings," etc. (1923) 32 Yale L. J. 213, and notes on the case in (1924) 22 Mich. L. Rev. 579, and 33 Yale L. J. 669 (1924). The quotation was: "The statute declares the carrier to be only a trustee for the excess over a fair return received by it. Though in its possession, the excess never becomes its property, and it accepts custody of the product of all the rates with this understanding. It is clear, therefore, that the carrier never has such title to the excess as to render the recapture of it by the government a taking without due process." In the same case Chief Justice Taft's language is "The carrier owning and operating a railroad" etc. That an owner's operation of his own property results in a trust income for another, indicates the labors which attend the judicial rationalizing of legislative fiat. Details of the legislation are given *infra* p. 258.

¹⁰ *In re Abraham S. Gilbert* 275 U. S. . . , 48 S. C. 210 (1918) revives New York Gas cases from another angle. *Newton v. State of New York* 259, U. S. 101 (1922) states that A. S. Gilbert was appointed master and sat for a total of 282 days of five hours. The record was 25,000 printed pages, in itself a heavy charge. The Supreme Court upset an allowance to him of \$118,000 remarking "If the time devoted to the entire service—282 days—be accepted as equivalent to one year, the total allowance is fifteen times the salary of the trial judge and eight times that received by the justices of this court. It may be compared to the compensation of the Mayor of New York City, \$15,000, the

or lack of it, in the administration of the scheme of regulation which the public has undertaken to conduct. Clearly so constant a factor is an "operating expense" in any business sense of the term. But how it enters as an operating expense in a litigation over rates is not so clear. If a utility which has amortized the costs of a past litigation over several years, gets entangled in a second litigation while the amortization payments continue, they are, admittedly, operating expenses in the second rate litigation; but are the costs of litigation in any given litigation a factor in determining the rate issues of that litigation itself?

In *Columbus Gas & Fuel Co. v. City of Columbus*,¹¹ arising upon an ordinance rate alleged to be confiscatory, Judge Hough of the Southern Ohio District, dealt with the question as follows:

"Two items, namely, \$22,050.07, designated 'rate case expense,' and \$15,000, designated 'advertising expense,' claimed by the company as items properly to be included in general expense, were eliminated by the master. These expenses are for legal services and for advertising in newspapers in preparation and contemplation of this litigation. These were the original items of a continuous line of extraordinary expense attributable and chargeable to the trial of the instant case. The court is of the opinion that they were not allowable.

"Legal expenses in connection with rate cases have been given the stamp of approval by courts, when these expenses have been incurred in rate litigations before commissions and before courts. *Monroe Gaslight & Fuel Co. v. Michigan P. U. C.* (D. C.) 11 F. (2d) 319, 325; *Winona v. M. W. L. & P. Co.* (D. C.) 276 F. 996. And also such items have been allowed in equity cases, such as this, where the finding was confiscation. *Patterson v. Mobile Gas Co.* (D. C.) 293 F. 208. The court is able to find no decision, however, where the court has held directly that the legal expense of the utility,

salaries of the Governor and members of the Court of Appeals of New York—\$10,000, and the \$17,500 paid to judges of the Supreme Court in the City of New York. Although none of these can be taken as a rigid standard, they are to be considered when it becomes necessary to determine what shall be paid to an attorney called to assist the court. His duties are not more onerous or responsible than those often performed by judges.

So far as the several decrees undertake to adjudicate the master's compensation they will be reversed and the causes remanded with instructions to fix the same within the following limitations." It set the total at \$49,250.

The case in 275 U. S. . . ., 48 S. C. 210 is the Supreme Court's follow up. It required Mr. Gilbert to show cause why he should not be punished for contempt in having received the \$118,000 notwithstanding the earlier decision.

See Professor Goddard's statement of like costs in other litigation in "Fair Value of Public Utilities" 22 Mich. L. Rev. 562 at 779.

¹¹ 17 F. 2d. 630 (1927). On the accounting problems see "Capital and Maintenance Expenditures in Public Utility Accounting," by J. H. Buckley, 4 Jour. of Land, P. U. Econ. 25 Feb. 1928.

arising in preparation and prosecution of its claim of unconstitutionality, is allowable, to directly produce or influence that unconstitutionality. Such would appeal to the court to be unreasonable as well as inequitable."¹²

A more recent rate litigation which a District Court of three judges disposed of in a forty page opinion wherein it discusses various operating expenses, dealt, among them, with the high costs of experting from afar. The case is *Idaho Power Co. v. Thompson et al Pub. Util. Commrs.*¹³ At page 575 the Court finds that:

"In its set-up of operating expenses, plaintiff charges an item of approximately \$53,000 per annum to be paid to the Electric Bond & Share Company of New York for what is denominated supervision and special service. Capitalized at 7 per cent., it represents an investment of approximately \$750,000 and is about equal to 57 per cent. of all other administrative and general office salaries. In addition thereto, payment is also made to the Bond and Share Company for other special services, and reimbursement is made for all traveling expenses."

Of this it said, in denying the inclusion of the item:

"In respect to business policy, generally a court will not substitute its own judgment for that of the managing officers of a utility company. . . . But it would seem that a very considerable part of the service covered by the contract and rendered by the Bond & Share Company has to do with financial matters, in respect to some of which we are unable to see how the consumers have any obligation. It may very well be that, by reason of its standing in the financial world, by its sponsorship, the Bond & Share Company strengthens plaintiff's credit and enables it to get cheaper money and to sell its securities advantageously. (Volume 2, p. 315.) But if, during the period of construction, it charges 8 per cent. on money used for that purpose, and through such special agency it actually secures the money at 6 per cent., the service accrues to the benefit of the promoters and the stockholders. Why should the service be charged to the consumers?"

¹² In *Idaho Power Co. v. Thompson*, P. U. Commissioner, 19 F. 2d. 547 (1927) the utility carried an item in its annual budget for expense of utility regulation. Its charge for the year in which the litigation in question took place, the Court allowed in principle but cut in amount. Apparently it was part of the cost of the very litigation.

¹³ 19 F. 2d. 547 (1927).

(b) RATE BASE VALUATION

When "one devotes his property to a use in which the public has an interest"¹⁴ he does not abandon it to the public whim. "The railroad property is private property devoted to a public use."¹⁵ As private property it is within a constitutional protection which has been phrased that "There must be a fair return upon the reasonable value of the property at the time it is being used for the public. * * * And * * * the value * * * is to be determined as of the time when the inquiry is made regarding the rates."¹⁶

But what is the method of reaching the value? This is the chiefest present day battleground. Various ordinary business methods being excluded¹⁷ the field is narrowed to two: namely, the so-called prudent investment theory, and the present cost of reproduction theory.¹⁸ Mr. Justice Brandeis, who is the leading judicial

¹⁴ The phrase is, of course, that of Chief Justice Waite in *Munn v. Illinois*, 94 U. S. 113 (1876), 24 L. Ed. 77.

¹⁵ Mr. Justice Hughes in *No. Pac. Ry. Co. v. No. Dakota* (1915), 236 U. S. 585, 595.

¹⁶ Mr. Justice Peckham in *Wilcox v. Consolidated Gas Co.*, 212 U. S. 19, 41 (1909).

¹⁷ See the discussion by F. G. Dorey in "The Function of Reproduction Cost in Public Utility Valuation and Rate Making" (1923), 37 Harv. L. Rev. 173, 174 for the argument which reads out of consideration "the use, as a measure of value of earning capacity under past or existing rates"; and the use of the outstanding securities. R. L. Hale in 18 Columbia L. Rev., 211; J. E. Kirshman, 35 Yale L. J. 812, also deal with the topic.

¹⁸ The literature is vast. It is collected, down to 1926 in the writer's "Cases and Authorities on Public Utilities" XV to XVIII.

The more recent literature is as follows:

For discussions for non-legal readers and auditors, see "Principles and Methods of Rate Regulation," A. T. Hadley, Yale Review for April 1927; Irving Fisher, Copyrighted article published in Boston Transcript, June 27, 1927; F. J. Lisman in same June 9, 1927; W. M. Daniels, ex-member Interstate Commerce Commission, Address before Connecticut Society of Civil Engineers, Feb. 16, 1927; Editorials, Boston Herald, June 28, 1927; New York Times, April 6, 1927.

In the legal periodicals and economic journals:

John Bauer, Effective Regulation of Public Utilities (book), 1925, Mac-Millan & Co., pp. 381; reviewed, Harv. Business Review, April 1926 (reply by Mr. Bauer in October 1926 issue, pp. 68-78), 36 Yale L. J. 291-5, Dec. 1926 by J. H. Gray of I. C. C. Valuation Bureau.

John Bauer, "Rate Base for effective and non speculative Railroad and Utility regulation," 34 Jour. of Pol. Econ., 479 (Aug. 1926), reply to H. G. Brown on R. R. Valuation and Rate Regln. in same Journal, Oct. 1925.

John Bauer, "Reproduction Cost and Desirable Public Utility Regln." 2 Jour. of Land and P. U. Economics 1, Oct. 1926.

J. C. Bonbright, "Value of Property as basis of rate regln.," 2 Jour. of L. P. U. Ec. 276, "The Problem of Judicial Valuation," 27 Colum. L. R. 498 (May '27): valuation from various angles assembled and discussed by the author of "Railroad Capitalization" and who is professor in Columbia Business School; "Depreciation and Valuation for Rate Control," 51 Quart. J. Econ. 188, Feb. '27.

exponent of the first named theory, says in a notable opinion:¹⁹

"If the replacement cost measure of value and the prevailing-rate measure of fairness of return should be applied, a company which raised, in 1920, for additions to plant, \$1,000,000 on a 9 per cent. basis, by a stock issue, or by long-term bond issue, may find, a decade later, that the value of the plant (disregarding depreciation) is only \$600,000, and that the fair return on money then invested in such enterprise is only 6 per cent. Under the test of a compensatory rate, urged in reliance upon *Smyth v. Ames*,²⁰ a prescribed rate would not

N. T. Guernsey, "Principles underlying reasonable rates," 2 Ala. L. R. 3 (Jan. 1927): "State Commission Laws regulate rates not profit" 13 Va. L. R. 257, Feb. 1927. Mr. Guernsey is Vice Pres. and counsel Am. Tel. & Tel. Co.

L. A. Harr, "Economic factors involved in maintenance provisions of Public Utilities Corporate mortgages issued in series," 75 U. Pa. L. R. 302 (1927); by Professor of Finance, U. of Pennsylvania.

R. L. Hale, "Value and Vested Rights," 27 Colum. L. R. 527 (May, 1927) by foremost legal-economics student of the topic, of Columbia Univ.; "Non cost standards in rate making," 36 Yale L. J. 56 (Nov. 1926).

R. B. Perry, "A General Theory of Value" Longmans 1926 (book) Rev., 27 Colum. L. R. 622 (May 1927) by Eliz. Sanford. Discussion by a philosopher.

G. G. Tunnell, "Value for taxation and for rate making," 35 J. Pol. Econ. 1-38, Feb. 27.

C. M. Updegraff, "Deductions from the economic bases of Public Utility Rates," 12 Iowa L. R. 249 (April 1927).

"Rate Making and Excess Income," G. G. Tunnell, 8835 J. of Pol.-Econ. 725-75, Dec. 1927. (Review of valuation in general as to railroads; down to recent cases).

"The Valuation doctrine at the cross roads," M. C. Glaeser, 3 Journal of Land and Public Utility Economics, 241. (On McCardle and O'Fallon Cases; the courts and commissions at loggerheads).

"Index numbers of Public Utility Construction Costs," same, 343, P. J. Ravel, Nov. 1927.

"Comments on Legislation and Court decisions," same 434, Lilienthal and Rosenbaum. (Conclusion that there is not a new level but is likely to be a considerable readjustment in the costs).

"The Rate Base for Rate Regulation," 3 Indiana Law J. 225, 1927, by H. E. Willis, discusses the McCardle and O'Fallon cases together, and to the conclusion that the former is "erroneous." The latest discussion is in two valuable articles in the March 1928 Harvard Law Review. Under the general heading, "The Problem of Valuation," p. 564, Mr. Goddard writes on "The Evolution of Cost of Reproduction," and Mr. Bonbright on "The Economic Merits of Original Cost and Reproduction Cost."

¹⁹ In the Southwestern Bell Telephone Case, ante note no. 3 at 304. No student of the subject can fail to profit by a reading of this luminous exposition of the general problem notwithstanding the court's trend away from the positions which the Justice takes.

Gerard Henderson, since deceased at the threshold of high career, visualizes the business negotiations which theoretically might take place between a committee of prospective investors and a committee representing the community, in an arresting article in (1920) 33 Harv. L. Rev. 902, 1031.

²⁰ *Smyth v. Ames*, 169 U. S. 466 (1898). He says in the same opinion, p. 292, "The rule of *Smyth v. Ames* sets the laborious and baffling task of finding the present value. . . . The adoption of present value . . . was urged in 1893 on behalf of the community and it was adopted by the courts largely as a pro-

be confiscatory if it appeared that the utility could earn under it \$36,000 a year, whereas \$90,000 would be required to earn the capital charges. On the other hand, if a plant had been built in times of low costs, at \$1,000,000, and the capital had been raised to the extent of \$750,000 by an issue at par of 5 per cent. thirty-year bonds, and to the extent of \$250,000 by stock at par, and ten years later the price level was 75 per cent. higher and the interest rates 8 per cent., it would be a fantastic result to hold that a rate was confiscatory unless it yielded 8 per cent. on the then reproduction cost of \$1,750,000. For that would yield an income of \$140,000, which would give the bondholders \$37,500; and to the holders of the \$250,000 stock, \$102,500,—a return of 41 per cent. per annum. Money required to establish in 1920 many necessary plants has cost the utility 10 per cent. on thirty-year bonds. These long-time securities, issued to raise needed capital, will, in 1930 and thereafter, continue to bear the extra high rates of interest which it was necessary to offer in 1920 in order to secure the required capital. The prevailing rate for such investments may, in 1930, be only 7 per cent., or, indeed, 6 per cent., as it was found to be in 1904, in *Stanislaus Co. v. San Joaquin & K. R. C. & I. Co.*, 192 U. S. 201; in 1909, in *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; and in 1912, in *Cedar Rapids Gaslight Co. v. Cedar Rapids*, 223 U. S. 655, 670. A rule which limits the guaranteed rate of return on utility investments to that which may pre-

tection against inflated claims. . . . Reproduction cost as the measure, or as evidence, of present value, was, also, pressed then by representatives of the public who sought to justify legislative reductions of railroad fares."

In the *Smyth-Ames* Case the general subject got its first airing and the late William Jennings Bryan led the support for the Nebraska rate setting statute. Professor Goddard in 22 *Michigan L. Rev.* at 655 says, "*Smyth v. Ames*, *supra*, steered a compromise course between the Scylla of public demand for present cost-of-reproduction and the Charybdis of the utilities insistence on the amount of outstanding securities, stocks and bonds. The case involved rates fixed by a Nebraska statute. Mr. Bryan for the state insisted 'that the present value of the roads, as measured by the cost-of-reproduction, is the basis upon which profit should be computed. . . . Railroads should be placed upon the same footing as an ordinary business enterprise. . . .'

"Justice Harlan, who wrote the opinion, . . . suggested a rule that answered the purpose of proving the statutes invalid, and committed the court to nothing for the future, the compromise known as the rule of *Smyth v. Ames* (saying):

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case.'"

Mr. Goddard's article in the March Harvard Law Review cited in note 18 gives a further analysis of the facts as to *Smyth v. Ames*.

vail at the time of the rate hearing may fall far short of the capital charge then resting upon the company."²¹

It will be observed that the process is the twofold one of, first, assigning a "value"; and, secondly, of multiplying it by some figure which represents a fair return on the value. The resultant total—disregarding subsidiary items—is the charge which the utility may ask its customers, collectively, to pay. The fair return figure is adverted to later; for the present the problem is as to the "value."

Notwithstanding this opinion of Mr. Justice Brandeis, the court in the *Southwestern Bell Telephone Case* bluntly asserted that "If the highly important element of present costs is wholly disregarded" the finding of value was to be reversed; and "obviously the commis-

²¹ Mr. Dorety in the article mentioned in note 17 ante says at p. 181 that Mr. Justice Brandeis argues the heavy losses to those who invest during high price periods and the fantastic profits to those who invest in low price periods, but adds that this simply puts utility investors on a par with other investors. He continues "If we understand the suggestion correctly, it is that the investor should be permitted to build the plant in 1920 and to fasten upon the consumers an annual charge of \$140,000 per year for thirty years, to pay for a service which they could reproduce a few years later at an annual charge of \$50,000. If this theory could be put into practice, it would afford a unique opportunity for investors. In no other known way could the investor project the benefits of temporary high prices and high interest rates so far and so certainly into the future. The result would be to put an extraordinary premium on the construction of utility plants during peak price periods."

He argues that the theory would drive capital out of utility construction in low-price periods and impel it in high-price periods when unnecessary investment should be discouraged. The assumption that the utility collect on its original cost is, he says, of the essence, yet no public guaranty of such a return is suggested by anybody and the competition of new utilities, private or public, would drive rates down to reproduction levels. "The doctrine of original cost, therefore, would prevent the investor from earning a return on more than his original investment, but it would give him no assurance against a smaller return. He could lose by a fall in prices but could not gain by a rise. No prudent investor would trust his savings in such an enterprise. The proponents of this doctrine, therefore face a dilemma. If they are right in assuming that a return on a high construction cost can be collected in a subsequent low price period, they will impose an intolerable burden upon the reduced capacity of the shipper for payment. If such a return cannot be collected, the utility will not be built, for the investor will not face the possibility of loss with no possibility of gain."

Mr. H. B. Brown discusses in 12 Calif. L. Rev. 283 (1923) the "Defects of Mr. Justice Brandeis' theory of prudent investment."

Mr. Justice Brandeis in his note 13 cites various writers as in accord with his views; saying "Compare Edwin C. Goddard, 'Public Utility Valuation,' 15 Mich. L. Rev. 205; Robert L. Hale, 'The "Physical Value" Fallacy in Rate Cases,' 30 Yale L. J. 710; Donald R. Richberg, 'A Permanent Basis for Rate Regulation,' 31 Yale L. J. 263; Robert H. Whitten, 'Fair Value for Rate Purposes,' 27 Harv. L. Rev. 419; Henry W. Edgerton, 'Value of the Service as a Factor in Rate Making,' 32 Harv. L. Rev. 516; Gerard C. Henderson, 'Railway Valuation and the Courts,' 33 Harv. L. Rev. 902, 1031; Armistead M. Dobie, 'Judicial Review of Administrative Action in Virginia,' 8 Va. L. Rev. 477, 504. See also 32 Yale L. J. 390, 393; 19 Mich. L. Rev. 849."

sion undertook to value the property without according any weight to the greatly enhanced cost of material, labor, supplies, etc., over those prevailing in 1913, 1914, and 1916. As a matter of common knowledge, these increases were large. Competent witnesses estimated them at 45 to 50 per centum." The Missouri Commission thereafter added 50 per cent. to the figures²² it had based on investment costs.

This *Southwestern Bell Telephone Case* and two other²³ cases which the Supreme Court decided at about the same time, were not, however, accepted as giving any definitive theory. Judge Rosenberry of Wisconsin in *Waukesha Gas and Electric Co. v. Railroad Commission*²⁴ says of them: "Recent decisions having left us without a guide as to the weight which is to be attached to the cost of reproduction new," he valued as per prudent investment by preference. The field as to the theory of valuation continued to be regarded as an open one, therefore, and critical comment continued to discuss the competing viewpoints. Within the last year and a half, however, we have had two decisions which bid fair to bring to a head, and to a definitive ruling, the whole question. These decisions are of outstanding importance, not only in themselves, but in their relations to each other and to the judicial attitude toward the result of administrative action. The one involves the dealing of State authority with a local utility of no interstate character; the other concerns the valuation of the railroads by the Interstate Commerce Commission. They are, respectively, *McCardle v. Indianapolis Water Co.*,²⁵ and the *O'Fallon Case* (Excess Income of St. Louis and O'Fallon Ry. Co.).²⁶

The *McCardle*²⁷ litigation began when, in 1923, the Indianapolis

²² Re United Railways P. U. R. 1923 D. 759, 850.

²³ The others were *Bluefields Water Wks. etc. Co. v. P. S. Comm.*, 262 U. S. 679; and *Georgia Ry. & Power Co. v. R. R. Comm.*, 262 U. S. 625. See, on these cases, a note by Professor Goddard in 22 Mich. L. R. 147 (1924). Mr. Goddard has written illuminatingly on the history of valuation in a similar note; 19 Mich. L. R. 849 (1921), and in articles in 15 Mich. L. R. 205; and in 22 Mich. L. R. 652, 777 (1924), where he discussed the decisions from the early cases following *Mumm v. Illinois*, down to include the 1923 trinity mentioned above.

On the irreconcilability of the three decisions, see D. R. Richberg, "The Supreme Court Discusses Value," 37 Harv. L. R. 289 (1924).

²⁴ 181 Wis. 281 (1923); 194 N. W. 846.

²⁵ 272 U. S. 400, 47 S. Ct. 144, Nov. 1926.

²⁶ 124 I. C. C. 3, Feb. 1927. See the precise title in note 7 ante.

²⁷ The case was the subject of a good deal of direct comment. "What is fair return? What is present value?" Boston Herald, Dec. 2, 1926. "A Startling Decision," editorial Boston Herald, Jan. 7, 1927. "Spot reproduction cost

Water Company filed with the State Public Service Commission, of which McCardle was chairman, a schedule of increased rates which the City of Indianapolis opposed. There followed the usual battle of books and experts.²⁸ The Commission found that as of May 31, 1923, the value of the property used was not less than \$15,260,000; that the return under the existing rates would be \$800,000; that 7% would be a reasonable rate. It therefore granted, effective January 1, 1924, an increase, but not the increase asked for, and the Water Company asked the local Federal Court to enjoin the enforcement of the order on the ground that the rates prescribed were confiscatory. The District Court having orally declared for the Water Company, the case came to the Supreme Court on appeal from the injunction. It was affirmed.

The Water Company's success lay in convincing the District Court that a valuation of \$19,000,000 should have been the basis of the commission's calculation, but the battle ground was on theory rather than on calculation of figures, for the City and the Commission "contend that the Court adopted * * * the cost of reproducing new less depreciation, estimated on the basis of spot prices as of January 1, 1924 * * * ." The Water Company "says that the cost of reproduction less depreciation, estimated at such prices, was shown to be more than \$22,500,000 and that the Court did not adopt such costs as a measure or give them undue weight as evidence of value."

Mr. Justice Butler, writing for the Court his first opinion on the subject, recites that the Commission's own engineer had "testi-

as the rate bases for Public Utilities," note 27 Colum. L. R. 721-5, June 1927, which concludes that it is "An error which must be corrected"; "Value by judicial fiat," an article by D. R. Richberg, 40 H. L. R. 567-82, Feb. 1927; "The Ohio Valley Water Company Case and the Valuation of R.Rs.," article by J. G. Buchanan, 40 H. L. R. 1034 at 1047, June 1927; "The valuation of Public Utilities," by G. L. Goldberg, H. W. Irig., 11 Marq. L. R. 242, June 1927 which compares McCardle and O'Fallon cases; "Cost of reproducing new less depreciation as the rate base" note 11 Minn. L. R. 674-5, June 1927; "Valuation of properties for rate making purposes summarizing note, 13 Va. L. R. 483, 93, 1927; "Price fluctuations in rate making valuation," note 36 Yale L. J. 1151-5, June 1927, discussion of McCardle and O'Fallon cases; "The McCardle Case," 5 Harvard Business Review 496, July 1927.

²⁸ Mr. Justice Brandeis in the Southwestern Bell Telephone Case, 262 U. S. 276 at 291 lists the items of inquiry in four headings. He points out that the results are achieved by either "prediction" or "opinion" and that a "decision . . . is thus the resultant of four subsidiary determinations. Each of the four involves forming a judgment, as distinguished from ascertaining facts. And as to each factor there is usually room for difference in judgment."

fied that on the basis of prices prevailing January 1, 1924, the cost of reproduction less depreciation was \$19,500,000." He continued:

"It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase. The decision of this court in *Smyth v. Ames*, 169 U. S. 466, 547, declares that to ascertain value 'the present as compared with the original cost of construction' are, among other things, matters for consideration. But this does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand. By far the greater part of the company's land and plant was acquired and constructed long before the war. The present value of the land is much greater than its cost; and the present cost of construction of those parts of the plant is much more than their reasonable original cost. In fact, prices and values have so changed that the amount paid for land in the early years of the enterprise and the cost of plant elements constructed prior to the great rise of prices due to the war do not constitute any real indication of their value at the present time. *Standard Oil Co. v. So. Pacific Co.*, 268 U. S. 146, 157; *Georgia Ry. v. R. R. Comm.*, 262 U. S. 625, 630-631; *Bluefield Co. v. Pub. Serv. Comm.*, *supra*, 691-692; *Tel. Co. v. Pub. Serv. Comm.*, *supra*, 287. Undoubtedly, the reasonable cost of a system of waterworks, well-planned and efficient for the public service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as there is no change in the level of applicable prices. And, as indicated by the report of the commission, it is true that, if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands, plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property," p. 410.

Mr. Justice Brandeis dissented, Stone, J., joining him. The former said:

"The commission and the lower court likewise agreed that reproduction cost was evidence as to value. The primary questions on which they differed are these. Is a finding of reproduction cost tantamount to a finding of value? Is the reproduction cost which should be ascertained by the tribunal, the 'spot' reproduction cost—that is, cost at prices prevailing at the time of the hearing? The District Court, as I read its opinion, answered both of these questions in the affirmative. The learned judge assumed that spot reproduction cost is the legal equivalent of value. He found that \$19,000,000 was, on

the evidence the lowest conceivable spot reproduction cost. He assumed that, since the utility was willing to accept this minimum as reproduction cost, no amount less than that could be found by him to be the value, or rate base. He believed that recent decisions of this court required him so to hold. In this belief he was clearly in error.

"That reproduction cost is not conclusive evidence of value has been repeatedly stated by a unanimous court.

"There is, so far as I recall, no statement by this court that value is tantamount to reproduction cost." (p. 421)

Thus is an apparently definitive²⁹ formula arrived at as to the operating theory. The dismay of some of the writers is manifest, particularly those who attempt to read the future of railroad valuation. Others are less worried.³⁰ Since in the O'Fallon case the Commerce Commission itself split on its theory and the preponderance in it was against Mr. Justice Butler's, the possibility of "distinguishing" railroads from other utilities or of "distinguishing"^{30a} state from federal valuation, keeps the subject still under discussion and still a debating ground. But as to the limitations imposed by the fourteenth amendment, as read by the Federal Supreme Court, upon the states in their valuation of the utilities which lie in their province to regulate, it seems that until the Supreme Court in later opinions tacks down the corners of the McCardle case, one way or another, they must value as per spot reproduction.

In the McCardle case the investment seems to have been about \$8,000,000. So long as society permits unearned increment in other investment, the utility investor's human impulse toward the same treatment will drive him to prefer the reproduction "value" and to take his chances with its ups and downs. The chances Mr. Justice Butler accepts when he says, "It is well established that values of utility properties fluctuate and that owners must bear the decline and are entitled to the increase." The Massachusetts commission

²⁹ Mr. Donald Richberg's article in 40 H. L. R. 567, "Value by judicial fiat" sees in the case an end of rate regulation according to prior standards. He analyzes the opinion and comes to a conclusion, p. 571, that the seal of approval is put on a method, as "*decisive*" (his italics), which is generally repudiated by students of the subject (whose work he lists). The note in 27 Columbia Law Review 721 is not less positive, saying that the "equation of spot reproduction cost to value . . . is an error which must be corrected."

³⁰ W. M. Daniels, formerly a member of the Commerce Commission, and now Professor of Transportation at Yale, is one. See note No. 18 ante.

^{30a} This is one of Mr. Goddard's points. See 41 Harv. Law Rev. 589. Mr. Bonbright, p. 593, shows an eagerness for its adoption. The present writer sees no justification for a distinction.

rejects the reproduction basis on the assumption that the prudent investment theory gives stability. Just how the prudent investment theory combats the present difficulties arising out of conditions other than the ordinary case of land increment is not so clear.³¹ Furthermore, whether a democracy would allow itself in 1930 to be charged, on the investment theory for the value a plant in which 20,000,000 1920 dollars had been invested—and borrowed at 1920 rates, so that fixed charges are high; when in 1930 a similar plant could be put up for \$10,000,000, and the money borrowed at a lower rate,—is sufficiently problematical to justify the utility investor's desire to share in the "profits" of inflation.³² Railroad valuation shows how readily any large utility's affairs may cease to be looked at judicially or with the economist's eye, and become a matter for demagogues.

The *O'Fallon* case already referred to threatens to bring to a head many problems: Whether the Federal Government's authority is subject to the same limitations under its appropriate constitutional provisions as is that of the states; whether the Commerce Commission must take the same methods as the Supreme Court imposes upon the State Commissions? Underlying, if the Supreme Court should reject the labors of the Commission, either on its fact findings or on its valuation theory, is the question, largely political, "Do we want to go on with what we have begun under the Valuation Act of March 1, 1913?"³³

³¹ Professor Irving Fisher's graph, Boston Transcript, June 27, 1927, of the purchasing power of the dollar in the article in note No. 18 ante, shows that the 1913 dollar which he takes as his yardstick, was worth 2, plus, 1920 dollars.

³² No one, so far as the writer knows, has suggested a possible in between. "By investment in a business dedicated to the public service, the owner must recognize that, as compared with investment in private business, he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit," says Taft, C. J., in the Recapture Case (263 U. S. 456). His profit rate is publicly set, and aimed, under either theory of valuation, at some figure designed to be the least bait adequate to induce investing. Beside this, his business comes under manifold special interferences and burdens. He might well add together these items of discouragement, and ask in consideration of them, a reproduction valuation which would share "prosperity" in periods of inflation and an investment valuation which would give him at other times what he could earn on his investment. He would thus be given the option of theory and would select according to his interest. No doubt this is too much to be hoped for by any utility, yet the Massachusetts bills referred to later at page 271, have certain aspects of guaranty.

Professor Goddard, 22 Michigan L. Rev. at 781, has pointed out the suspicious coincidences by which the "value" in many of the cases has looked like an average of the resultants under the different theories.

³³ Sec. 19a of the Interstate Commerce Act. It was amended by Act, Feb. 28, 1920, Sec. 433 and Act, June 7, 1922, Secs. 1, 2, (Comp. St. Sec. 8591). The history is set forth in *Kansas City So. Ry. Co. v. U. S.*, 19 F. 2nd. 591 (Dec. 31, 1926), D. C. 3 judges.

By that legislation the Commerce Commission was set the task of ascertaining "the value of all the property owned or used by every common carrier subject to this act." Moved for by the Commission itself as early as 1903 and urged in the Commission's annual request for legislation in the years 1908, 1909, 1910, 1911 and 1912, it was, indeed, a logically necessary step after the Commission secured the power to set up rates; but its staggering implications have appalled even the Commission at times.³⁴ Once it was accomplished on any accepted basis, the other provisions of the Transportation Act giving the Commission control over the issuance of securities³⁵ fill in the sketch of a workable scheme for rate control. After years of labor and the expenditure of large sums of money³⁶ the Commission is arriving at valuation stages which are getting into the courts. Since the control of security issues is a necessary background for the prudent investment theory,³⁷ it may be that the Commission's success in getting supervision of the investments has colored its thinking on the valuation problem,³⁸ for its O'Fallon decision is a triumph for the investment theory.

³⁴ *K. C. So. Ry. Co. v. U. S.*, 19 F. 591 at 597, "Congress, the Commissions and the carriers appreciated the far reaching effect of the valuations to be made under the Act." Senator La Follette's remarks to that effect are quoted and the statements of railway officials. The magnitude of the task is discussed: "It has required about 10 years of intensive work by a large force of men, at an expenditure, by the government and the carriers, running up into millions of dollars. The use and usefulness of these valuations . . . is already evident."

³⁵ The Commission began to urge this as early as 1907. See for its history, "Federal Regulation of Railroad Management and Finance," K. F. Burgess, 37 *Harv. L. R.* 705, 521 (1924). See also, "Regulation of Security Issues by the Interstate Commerce Commission" (book), David P. Locklin, U. of Illinois Press, 1927.

Pres. Charles E. Mitchell of the National City Bank of New York speaking at the annual convention of the National Electric Light Association at Atlantic City, June 9, 1927, declared that in the last five year period while Public Utilities sold over \$7,000,000,000 of securities, and industrials \$10,000,000,000, the Railroads issued only \$3,000,000,000; that in 1920-4 the railroads received \$20 out of every \$100 invested, in 1925, only \$10.50, and in 1926, only \$7.50 out of every \$100. He deplored the Interstate Commerce Commission's insistence that before it approves an issue of securities the railroads show in detail how the money is to be used as barring the sound principle—as Mr. Mitchell sees it—of buying money when cheap for future use as yet undefined.

³⁶ See note 50, *infra*.

³⁷ See Mr. Justice Brandeis, *Southwestern Bell Telephone Case*, 262 U. S. 276, in his note No. 21, for the extent of the control.

³⁸ Mr. Commissioner Meyer's majority opinion, p. 37 in the O'Fallon Case, 124 I. C. C. 1 indicates that only the lack of record of the investment barred using the method throughout. He says that the valuation problem lies in two parts divided, in time, by the Act of 1913, and that as to the period post that date, the Commission had information as to the investment and used it.

The precise title "Excess Income of St. Louis and O'Fallon Railways Companys" indicates that it was a proceeding for the recovery of excess income brought under Section 15a of the Commerce Act, which requires the Commission to adjust rates so as to give a fair return on the value of the property, and which specifies that when the individual carrier earns in excess of a percentage on the value, one-half of the excess shall be paid to the Commission for a general railroad contingent fund.³⁹ As the Commission points out, "Congress well knew that the valuation under Section 19a of the Act was not completed and could not be completed for several years," but the Commission felt that Congress meant immediate action nevertheless, and in the O'Fallon case it instituted proceedings without having made the valuations under Section 19a—the Valuation Act. A possible key to a disposal of the O'Fallon case lies in the Commission's assumption that "Congress apparently entertained the view that valuations under Section 15a might be made in a more summary manner than valuations under Section 19a."⁴⁰ Notwithstanding this apparent disclaimer of the question of general valuation, the Commission, nevertheless, wrote what will be a classical exposition of the opposing theories. The opinion is long—seventy pages—of which fifty-nine are from the majority in two opinions by Messrs. Meyer and Eastman. Four of the ten members dissented, each with opinion, though all four joined in that of Mr. Hall.

Six per cent. is now allowed on the value. On the value of what? The "what" in the particular case was no colossal thing. The rail

³⁹ *Dayton Goose Creek Ry. Co. v. U. S.*, 263 U. S. 456 (1924), established the constitutionality of this scheme for making the strong sustain the weak. Professor W. Z. Ripley's report to the Interstate Commerce Commission on Consolidation of the Railroads, 63 I. C. C. 469, 476 (1921) shows its purpose as a club toward consolidation, in that the strong roads might find it cheaper to support the weaker by adopting them than by paying toward their outdoor relief. There is a movement for the modification of Section 15a and a bill has been introduced in the House which is explained in *Railway Age*, Vol. 82, p. 1430 (May 14, 1927).

⁴⁰ The assumption seems unfortunate. The word "valuation" has already too many meanings. The case has not been differentiated by those discussing it and the counsel in the case were selected presumably because they were expert on the general valuation problem. Edgar E. Clark, for the carriers, was an Interstate Commerce Commissioner at one time: Donald R. Richberg and H. L. Ekern appeared for the National Conference on Valuation of American Railroads, John E. Benton for the National Association of Railroad and Utilities Commissioners, F. G. Dorety and others as *amici curiae*. Mr. Richberg had written "A permanent basis for rate regulation" 31 *Yale L. J.* 263 (1922); "The Supreme Court discusses value" (*Southwestern Bell Telephone Case*) 37 *Harv. L. R.* 289 (1924); "Value—by judicial fiat" (*McCardle Water Company Case*) 40 *Harv. L. R.* 567 (1927). Mr. Dorety's article "Function of reproduction cost in valuation" 37 *Harv. L. R.* 173 (1923) is well known.

way here made famous was nine miles long, but the Commission was not unmindful of "how great a matter a little fire kindleth." Commissioner Meyer said, p. 26: "There is here presented, in reality, a great national problem. * * * In essence it is presented as clearly as it could be in the case of a railroad involving hundreds of millions. * * * We must carefully review the significance to the nation of the decision which we make in this case in its bearings on the relation between all the railroads and all the people of the United States."

The method adopted is stated, p. 37, as follows:

"In reality, the valuation problem is divided into two parts, which can be quite clearly distinguished, and the date when our valuation work under section 19a began marks roughly the division line between these two parts. Since that date we have required the carriers to report in detail all property changes and their costs, and these costs can be verified and checked. In the case of all property which came into existence prior to that date we have an inventory made by our own engineers, but no complete, reliable information as to original costs. The first part of our problem, therefore, is to determine upon a fair single-sum value for this older property. The second part of our problem is to bring this value down to any subsequent date, in the light of the property changes since our valuation work began, of which we have complete reports.

"The methods which we have followed in determining the basic values of the older property have been described at length in our valuation reports under section 19a. Briefly, we have had before us the cost of reproduction new of the structural portion of this property estimated on the basis of our 1914 unit prices, coupled with the knowledge that costs of reproduction so arrived at were not greatly different from the actual original costs. We have had complete information as to the depreciation of this property, in other words as to that portion which in reality had ceased to exist because of the consumption of service life. We have had complete information as to the value of the railroad lands, based on the contemporaneous market values of adjoining and adjacent lands. We have had information, as complete as could be secured, relative to the financial and corporate history of the property, including its past earnings. We have further had such information as could be developed with reference to possible appreciation in the value of certain parts of the property because of better adaptability for use, and with reference to such other matters as the carriers desired to bring to our attention.

"From this accumulated information we have formed our judgment as to the fair basic single-sum values, not by the use of any formula but after consideration of all relevant facts. In our opinion these judgments have been reasonably liberal to the carriers. In all

probability they are above rather than below the amounts which would have resulted if complete records had been available and the investment theory of valuation had been employed. But the public, as represented by the Government, must bear some of the responsibility for the absence of records, and it is fair, under all the circumstances, that the basic valuations should be reasonably liberal.

"In more than 400 reports relating to the value of individual railroad properties we have said :

"The estimates of cost of reproduction covered by this report are based upon what is referred to herein as the 1914 level of prices, while the present values of the common-carrier lands covered by the report are based upon the fair average of the normal market value of lands adjoining and adjacent to the rights of way, yards and terminals of the carrier, as of valuation date. This discrepancy will be removed when the commission adjusts to later dates, in accordance with the requirements of the Valuation Act, the final value herein reported.

"What we are doing in the instant case is in conformity with our understanding of this language.

"When it comes to bringing these basic valuations so arrived at down to any subsequent date, however, no good reason appears for doing more than making the necessary adjustments to reflect the property changes which have since occurred and which have been fully reported to us, and to reflect any further depreciation of the property. By the adoption of such a method of bringing values down to date we shall achieve the stability of rate base which we have found to be essential to a wise and just plan of public regulation. The method has the further advantages, also, that it is simple and easy of application and involves no great expense or delay and that its results are capable of reasonably accurate forecast. It insures fair treatment to the investor because a fair return will be secured for every dollar that has gone into the project, provided, of course, that traffic is available. Whatever the price level may be, however severe the fluctuations, this method will result in yielding a fair return on every dollar invested and remaining in the property. This is the greatest assurance which can be held out to prospective investors. No stronger inducements can be offered in fairness to all the interested parties."⁴¹

Commissioner Meyer dealt only with the exposition of the decision. Its controversial aspects were handled by Commissioner

⁴¹ As to price levels, Meyer C. said: "Under the method outlined above we do give weight to such changes in so far as they have been reflected in prices paid for new construction or replacements, and we value lands at their prevailing market values. We know of no other way of giving weight to this factor which is not dependent upon caprice, unless full weight be given under the current reproduction cost doctrine. There is, in our judgment, no intermediate process possible which is capable of being applied by any rule independent of the caprice of those who apply it." p. 39.

Eastman⁴² concurring. He denied that the decision had "disregarded the law as laid down by the Supreme Court," considering that the Court had "wisely avoided a crystallization of the Law," but he boldly asserted that if there was a disregard it was in no static matter, for the issue was one of public policy. The Commission's knowledge and experience in instances where the law "is influenced if not governed by the facts" was such that he read the Supreme Court's cases in such a manner as to leave the Commission empowered to speak frankly and fully. After so reading his assignment his opinion goes on to an attack upon the theory of the "cost of reproductionists" and a statement of faith in the prudent investment doctrine. His only quarrel with the decision is that the Commission arrived at part of its figures "by estimating cost of reproduction new in 1914 at 1914 unit prices," etc. "It has seemed to me," he says, "both preferable and feasible where records of actual costs are not available, to estimate what the property should reasonably have cost."⁴³

The thesis of the dissent is simple: after quoting the cases, including the McCardle Case, Hall, C., says, p. 62:

"It follows that, under the law of the land, in determining the value of the O'Fallon for any of the purposes contemplated by either section 19a or 15a, the valuation and the recapture provisions of the act which we administer, we must accord weight in the legal sense to the greatly enhanced costs of material, labor, and supplies during the periods of inquiry, here the recapture years, over those prevailing in the pricing period. The majority in according no weight to such evidence disregard highly relevant facts, established by competent testimony and undisputed. They offer no justification except a forecast of unfavorable economic results, an exposition of better results to be anticipated from safeguarding the amount prudently invested in the property rather than the value of the property itself, and a doubt whether the courts, when called upon to construe the valuation and recapture provisions of the interstate commerce act,

⁴² The Railway Age has had a series of discussions taking to task the majority view, in general, and Mr. Eastman's position in particular, in its volume 82: "When Commission and Court disagree," p. 1107 (Apr. 9, 1927): "The dilemma of the railways," p. 1780 (June 11, 1927) criticising the departure from the law: "The Commission as a special providence," Vol. 83 p. 323 (Aug. 20, 1927).

Mr. Eastman adhered to his general views in a speech at Washington, D. C., on December 29th, 1927, before the American Political Science Association.
⁴³ In *Kansas City So. Ry. Co. v. United States*, 19 F. 2d, 591, 598 (Dec. 1926), the Court of three judges specifically repudiated this, though deciding that the Commission had in other ways exceeded its powers in making the valuation.

would still apply the principles of valuation enunciated by the Supreme Court in cases which did not arise under that statute. The election made by the majority is deliberate. They say, "What we do in this case we must in principle do for all the railroads in the United States."

Commissioner Aitchison, dissenting, adds: "But this is not the appropriate place to discuss the economic and political results of the enforcement of a rule laid down by the Supreme Court. Our present duty is to ascertain the rule of law and enforce it."

Commissioner Woodlock dissented from the majority's economic theory that stability was to be achieved by linking the railroad investment to the dollar, as he phrased it. Stabilize the dollar, he says.

Thus is neatly laid out the wherewithal for one of our most momentous decisions. The significance of the forthcoming decision is sensed, in editorial comment and special writing, in the leading papers which no longer treat the "law," in this particular at least, as a thing apart from the affairs of everyman.⁴⁴ As an editorial writer in the *Boston Herald* says (June 28, 1927), "the whole population are interested in the outcome."⁴⁵

On December 10, 1927, a District Court of three judges for the Eastern District of Missouri sustained the Commerce Commission's order. The wide initial announcement that the court had specifically upheld the majority's valuation theory, is scarcely true. The opinion, 22 Fed. 2nd. 980, actually avoided so doing; and the case went off on the point that,

"The United States contends that there is no question of confiscation presented here and no need to examine the accuracy of the values found by the Commission or its methods used in determining

"The New York "Times," April 6, 1927, says editorially that the bases of the divergences in the Commission indicate that only a Supreme Court decision can determine the Commission's course. F. J. Lisman, writing in the *New York Journal of Commerce*, says that after all the job is to attract capital; and that as that can be done by juggling the rate of return, the valuation is merely incidental (*Boston Transcript*, June 9, 1927). Yet the President of the Seaboard Air Line has declared that the railroads do not accept the valuation and will look to the Supreme Court (his annual report for 1926 as per *Boston Transcript*, June 27, 1927) and it is clear that they are not likely to be consoled by Mr. Lisman's philosophy. Meantime, two eminent economists are with the railroads, and say so. Irving Fisher, as reported in the *Boston Transcript*, June 27, 1927, opposes the investment theory in the interest of the bond holders; and W. M. Daniels lately of the Commerce Commission and now Professor of Transportation at Yale, joins him in that view (Speech, Feb. 16, 1927, before Connecticut Society of Civil Engineers).

⁴⁴The Case has got into the popular weeklies. See Merle Thorpe, editor, *The Nations Business*, in *Colliers*, August 27, 1927: he calls it the "Biggest Law Suit of Our Age" and suggests that its outcome will turn the question of government ownership.

such values because even if it might be contended that the above value claimed by the O'Fallon is correct, yet its net earnings thereon would, less the amount ordered paid over to the Government by the order of the Commission, be an ample return thereon for each of the recapture periods.

"For the purpose of resolving this contention made by the Government, the value of the O'Fallon may be taken, as claimed by it, to be \$1,350,000. There is no dispute as to the net earnings (undiminished by any recapture proceeding) as to each of the above four periods. Such earnings were as follows:"

It then went into an analysis of the figures and of the law governing recaptures as laid down in the Recaptures Case, 263 U. S. 456, and arrived at the conclusion that

"From the above law and facts, it seems that this contention of the United States is well founded; that the verity of the Commission's valuation herein need not be examined, and can not affect this recapture order, and, therefore, that such order is not open to attack upon the ground of wrongful valuation. If this be true, it is unnecessary to examine and determine the various contentions made by the parties and amici curiae concerning the proper manner of ascertaining value herein."

Judge Faris, concurring in the result in a separate opinion took a tack which may be prophetic. He said:

"The question here, I repeat, is one of valuation for recapture of profits purposes, and not one of valuation for rate-making purposes. The matter of valuation for rate-making purposes is involved incidentally and adventitiously only. With deference, then, I am of the view that this Court cannot avoid the necessity of meeting the question of legal methods of valuation, *vel non*, face to face.

"No excusable reason exists for adding to the length of these views by setting out the reasons for the positions I take upon the propositions. I content myself by saying that my opinion is:

"(a) That from the case of *Smyth v. Ames*, 169 U. S. 546, 547, to the last utterance of the Supreme Court of the United States, no hard and fast rule has ever been laid down by that Court touching the manner of the valuation of the properties of railroads used in the service of transportation."

The spread between the "value" of the nation's railroads as a whole calculated on spot reproduction, as compared with their "value" on the theory taken by the commission, is set at \$10,000,000,000-\$12,000,000,000. In this "biggest lawsuit in history" appeal to the Supreme Court was filed on February 8, 1928. Some forty

allegations of error are made of which the chief appears to be that the law of the land, i.e., the *McCardle Case*, was ignored.⁴⁶

What is the Supreme Court likely to do? One obvious answer is that it may handle the *O'Fallon Case* strictly as under Section 15 and thus avoid the general question as it did in another case of which much was hoped and little came. Aside from its suggestion of the Supreme Court's willingness to postpone "der tag" the case is worth a passing notice. *Los Angeles S. L. R. Co. v. U. S.*⁴⁷ is the first case to present to the courts the invitation to define the attitude toward the Commission's valuations under Section 19. It was a direct attack upon a valuation order and in a district court of three judges, was successful. Appeal by the Commission and the government gave them a victory in *U. S. et al v. Los Angeles S. L. R. Co.*⁴⁸

The "victory" simply upset a decree which had annulled the final valuation and enjoined its use by the Commission, but, though the railroads had raised objection to the method of valuation, the Supreme Court merely held that, on procedural grounds, the district court should have dismissed the bill. "There is the fundamental infirmity that the mere existence of error in the final valuation is not a wrong for which Congress provides a remedy under the Urgent Deficiencies Act." In denying that the general equity powers of the court would suffice, Mr. Justice Brandeis, who wrote for a united court, disposed summarily of the supporting arguments that the

⁴⁶ Writing a "Defense of the Work of the Commerce Commission" in the Boston Transcript, Jan. 7, 1928, F. J. Lisman writes "attention will be concentrated on the Supreme Court decision in the St. Louis O'Fallon Railroad Valuation Case. The decision of the District Court is probably of little importance because it may have been more or less hurried to expedite the case to the Supreme Court. If the Supreme Court should squarely decide this case on its merits and not on any technical legal point, then it will pass in principle on the question of whether twelve billion dollars of additional values claimed by the railroad companies actually exist or not. The extreme range is whether the carriers' properties are worth about twenty-two billions or about thirty-five billions.

If the court should unexpectedly take the carriers' claims at their full value, the result would probably be that the Commission would certify that 4½ per cent would be a fair rate of return under present conditions of the money market. The rate structure would then remain substantially the same as it is now. If the Commission were to authorize a rate structure sufficient to yield a 5¾ per cent return on the maximum values claimed by the carriers, Congress would promptly legislate the Interstate Commerce Commission out of office."

⁴⁷ 8 F. 2d. 947 (1925). It was noted, 39 Harv. L. Rev. 880 (1926).

⁴⁸ 273 U. S. 299; 47 S. C. 413, Feb. 21, 1927.

wrong valuation figures might hurt the road's credit, or that they might be used in recapture proceedings.⁴⁹

It was upon this decision that Commissioner Eastman relied (in the *O'Fallon Case* at p. 51), as an "invitation" to the Commission not to confine itself to the court's past utterances, and to make use of its own special knowledge aside from them. It might also be read as an invitation to the Commission to continue infinite labor and expense⁵⁰ under the possibility of an upset of result when actual use is sought to be made of the result. The postponement of decision seems therefore unfortunate, and the possibility of settlement offered by the *O'Fallon Case* is doubly welcome.

Speculation turns toward two matters of interest as one keeps the McCardle and *O'Fallon* cases, together, in mind; their relations to each other in the first place, and secondly, the bearing of the decisions as to court review of state commission valuations upon court review of a valuation by the Commerce Commission. The first named dealt with the limitations of the Fourteenth Amendment upon the state method of valuation. The restraints of the Fifth Amendment upon the Federal Government's method are to be read in the Railroad Valuation cases. Does the similar language of the Fourteenth and the Fifth Amendments mean that the spot reproduction method is imposed upon the Interstate Commerce Commission? Does the McCardle case decide any such matter as that? Aside from the theory on which valuation is made, what is the extent of the judicial oversight of the Commission's allotment of value to particular items for which value is allowed? In *Ohio Valley Co. v. Ben Avon Borough*,⁵¹ the Supreme Court held that "if the owner

⁴⁹ An editorial "Railroad Values Still in Question" in the Boston Herald of Feb. 23, 1927, puts it neatly, "In a word the decision is: You are not hurt yet: when you are hurt, then it is time to go to law."

The Los Angeles and Salt Lake Case was decided Feb. 21, 1927, subsequent to a decision of three judges in the Western District of Missouri on December 31, 1926, which, however, was not in the reports till 19 F. 2d 591. In it the railway filed its bill in equity to annul and suspend orders wherein the Commission made final valuations under Sec. 19, and succeeded. The Court had said: (p. 597 2nd column) "We think it cannot be said that the carriers have no legal rights affected until there arises an actual controversy in which it is sought to introduce such evidence." The Court then dealt specifically with the question of its jurisdiction, and decided that "The case is within the general equity jurisdiction of the Court. . . ."

⁵⁰ Up to December 31, 1926, four hundred and ten "final valuations" had been made by the Commission. Congress up to then had appropriated \$31,000,000 for the work and up to June 30, 1926 the railroads had spent \$92,000,000, according to "Valuation Progress" 82 Railway Age 461 (Feb. 12, 1927).

⁵¹ *Ohio Valley Water Company v. Ben Avon Borough*, 253 U. S. 287 (1920).

claims confiscation * * * the state must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, Fourteenth Amendment." What bearing does this, under the language of the Fifth Amendment, have upon the finality of the Interstate Commerce Commission's "final valuations" under whatever method it is required to follow?

In a learned article, "The Ohio Valley Water Company Case and the Valuation of Railroads," which appeared in 40 *Harvard Law Review* 1033, June 1927, Mr. John G. Buchanan, who was in the *Ben Avon Case*, on the winning side, undertakes to answer primarily the second of our questions, but gets incidentally into a reply to the first. His chief interest is in the *Ohio Valley Water Case*, and he spends some time in assuring himself that its "principle is settled law."⁵² From this starting point he goes on to establish the essential identity of the character of the restraints imposed on the respective state and Federal Governments by the Fourteenth and Fifth Amendments, and asks, "Since then the statutory and the constitutional provisions governing rate making orders and valuations by the Interstate Commerce Commission, are of like effect with (those governing the orders of the Pennsylvania Commission) should not the principle of the Ohio Valley Case be applicable to both alike?" After a searching examination of the cases he concludes, "that valuations of railroads by the Interstate Commerce Commission must be subject to review by the Courts upon their own independent judgment as to both law and facts." There is internal evidence in the article that the bulk of the authors' discussion antedated the recent valuation cases, and he shows a tendency to endeavor to distinguish the O'Fallon opinion as a recapture rather than a rate setting case; to label valuation for recapture "not a legislative act" though he admits that "by itself it appears to be an exercise of judicial rather than legislative power."

⁵² Most of those who commented on the case are hopeful that this is not so. To select one of many, Professor Ernst Freund, 27 *West Va. L. Q.* 208, concludes a paper which he read at the annual meeting of the Association of American Law Schools in 1920 with the opinion that the new doctrine "will turn out to be practically unworkable." Similar language appears in note 20 *Mich. L. R.* 232 (1920). See 25 *Mich. L. R.* 273 (1927) also for a late discussion of similar import.

Mr. Buchanan's point as to the Fifth and Fourteenth Amendments is scarcely assailable,⁵³ but the *Ohio Valley Water Case* is already sufficiently unpalatable as a decision in the problem of judicial review of administrative action without his general conclusion. A competent review by a Court of so vast a matter as a railroad valuation is, by itself, a distinctly sour prospect of interminableness and impossibility; to say nothing of its disruption of the valuable uniformities which lie in a scheme of evaluation by a single body acting with cumulative experience and on a constant principle. The imperative in "How can the Court do it?" will make the doctrine "law in books" rather than "law in action" as necessarily as expediency has stripped, to its mere words, the doctrine that "legislative power may not be delegated."^{53a}

Perhaps the *Ohio Valley Case* will turn out only a play upon a word. Justice McReynolds accents no part of his formula. The words "opportunity for submitting," etc., are not stressed; but an ingenious opponent of the case offers the somewhat casuistical suggestion that *opportunity* being given to the Court to review the facts, it will take them as the Commission finds.⁵⁴

In passing it may be said that in other matters the Supreme Court has heretofore been in a high degree mindful of the public investment in the Commerce Commission, and its sense of the question "Why is a Commission?" will presumably be no less real in the

⁵³ The rent law legislation coming up from the District of Columbia and from New York, gave the Court ample opportunity to identify or to distinguish. In *Block v. Hirsch*, 256 U. S. 135 the appeal was to "due process" under the Fifth, and in *Marcus Brown Holding Co. v. Feldman*, 256 U. S. 170 to "due process" under the Fourteenth Amendment. Neither in Justice Holmes' majority opinions, nor in the dissent filed for four justices, was any difference made. Justice McKenna, dissenting said in the first, "These provisions (Fifth) are limitations on national legislation with which this case is concerned and limitations (Fourteenth) upon state legislation with which *Brown v. Feldman* is concerned. We shall more or less consider the cases together, as they were argued and submitted on the same day and practically depend upon the same principle, and what we say about one applies to the other."

On the muddle of valuation as applied to the rent laws, see a note "How Should Reasonable Rent under the New York Housing Laws be Calculated?" 21 Colum. L. Rev. 802 (1921).

^{53a} See a note, 37 Harvard L. Rev. 1118 (1924), "The decadence of [this] fundamental constitutional maxim."

⁵⁴ See "Conclusiveness of the findings of the Interstate Commerce Commission under the Valuation Act," note 25 Mich. L. R. 273, 6 Jan. 1927. The author develops four possible ways in which the Supreme Court might handle the question: but dismisses those suggesting that the State and Federal Cases call for different treatment.

matter of valuation. How it will observe both the actualities and its formula will be eagerly awaited.

Meanwhile, however, valuation cases press upon the lower courts; and they record the labors in the lengthy opinions which the subject calls forth. They are of interest particularly as indicating the judicial readings of the effect of the *McCardle Case*. In *Brooklyn Borough Gas Co. v. Prendergast et al Constituting the Public Utility Commission of New York*,⁵⁵ the utility sought to defeat a statute setting for cities of over 1,000,000 population a rate of \$1.00 per thousand cubic feet, 650 B.T.U. and providing that the New York Utility Commission "shall not allow a rate in excess." The case illustrates the usual technique adopted in such inquiries in that it was referred to a special master⁵⁶ who reported that the rate was so clearly confiscatory that no test period under the prescribed rates was necessary. Agreeing, the District Court of three judges added a Brooklyn Borough Company victory to those five other New York City companies which had fought the statute.

The Master reported under the heading "Ascertaining the present value" that he had acted "without yielding to any one particular theory" and the Court in confirming his report, merely stated that "The valuations in the present case justify the same holding" (as in the other five cases settled in the local districts and affirmed by the Supreme Court). It referred to the *McCardle Case* as making an 8% return permissible, but did not advert to its bearing on valuation.

The *Columbus Gas & F. Co. v. City of Columbus*,⁵⁷ where the utility sought to enjoin the enforcement of an ordinance which cut natural gas rates to 40c per thousand, 900 B.T.U., the Court made a compromise decree and an uncertain sound on the *McCardle Case*: "The reproduction new less depreciation value, has frequently, and perhaps usually intervened as a commanding and dominating element. *Monroe Gaslight & F. Co. v. Michigan P. U. Comm.*, 11 F. 2nd 319; *Bluefield Co. v. Public Service Comm.*, 262 U. S. 679; *S. W. Bell Tel. & Tel. Co. v. P. S. Comm.*, 262 U. S. 276; *Georgia Ry. &*

⁵⁵ 16 F. 2d. 615 (Dec. 1926).

⁵⁶ In *Columbus Gas & Fuel Co. v. Columbus*, 17 F. 2nd. 630, he was allowed \$20,000 and the reporter \$5,200; In certain New York Gas cases a figure close to \$120,000 was quarreled over, see note No. 11 *ante*. The huge cost of the present methods is set forth in figures, which are eloquent in their mere statement, by Professor Goddard in his article, "Fair Value of Public Utilities," 22 Mich. L.-R. 652, 777 at 778 (1924). He shows an estimate of \$400 per mile as the cost of the Commerce Commission's railroad valuation.

⁵⁷ 17 F. 2d. 630 (D. C. Ohio, Feb. 1927).

P. Co. v. R. R. Comm., 262 U. S. 625; *McArdle et al v Indianapolis Water Co.*, 272 U. S. 400, 47 S. Ct. 141." The case is thus simply added to the list which has already been discussed as a category of discordants.⁵⁸

In Wisconsin the state court has already applied the *McArdle Case* to the subversion of its previous acceptance of the prudent investment theory. In *Waukesha Gas and Electric Co. v. Railroad Commission*,⁵⁹ it specifically declared against its previous decisions and rejects in the light of the Supreme Court ruling a valuation which the commission arrived at "by taking that (valuation) made in 1912 and adding thereto the costs of additions since made."

Meanwhile, in Massachusetts, which is the home of the prudent investment theory, as Mr. Kirshman recites its history,⁶⁰ the Worcester Electric Light Company is contesting a rate order of the state commission on the ground that the rate base cannot be the investment "value." Its reliance is upon the Indianapolis case, but in P.U.R. 1927 C 705, the Commission has decided that "We are of the opinion that, whatever the situation may be in other jurisdictions, the law does not require the adoption of such a rate base in Massachusetts." Its special reasons for moving the state out from under the Federal Supreme Court's jurisdiction are not very convincingly put, but its paragraph against a rate based on reproduction value as "not only unsound legally and historically, but also economically" is neatly done. A temporary injunction against the enforcement of the order has already issued out of the Massachusetts District Court, *Worcester Electric Light Co. v. Attwill et al.*⁶¹ The opinion of the three judges was stated in brief language. Judge Lowell, for the court, cited the *Southwestern Bell Telephone Case* and the *Bluefield Works Case* along with the *McArdle* decision; and, quoting from the latter, that "consideration must be given to prices and wages prevailing at the time of the investigation (p. 408 in 272

⁵⁸ See note No. 23 *ante*.

⁵⁹ 191 Wis. 565; 211 N. W. 760 (1927).

⁶⁰ In his article, "Principles of Competitive Cost in Public Utility Regulation," 1926, 35 Yale L. J. 805, 815.

The views of the Massachusetts Commission are set forth by Commissioner Eastman, of Massachusetts, in the O'Fallon Case, 124 I. C. C. I. at p. 53. In Bay State Rate Case 4 Ann. Rep. Mass. P. S. C. 3 P. U. R. 1916, F. 221, 233, the commission declared that "capital honestly and prudently invested must, under normal conditions, be taken as the controlling factor in fixing the basis for computing fair and reasonable rates."

⁶¹ *Worcester Electric Light Co. v. Attwill et al* Equity 2840 Opinion, Aug. 16, 1927, 23 F. 2nd 891.

U. S.) concluded: "It is apparent from the foregoing quotations [from the Commission's opinion] that this way of computing the value * * * was not followed. The decision of the department is contrary to the decisions of the Supreme Court of the United States."

Mr. Attwill, who is the chairman of the Massachusetts Utility Board, is the author of certain measures which have been introduced in the legislature whereby utilities are to be clubbed into a "contract" under which they agree to be regulated and their rates fixed under the Massachusetts plan.⁶² At this writing the matter is so largely in the formative stages that comment can be no more than casual, but the attempt of the Commonwealth to deal with the situation will, no doubt, provide interesting litigation if the bill passes.

In *Temmer v. Denver Tramway Co.*,⁶³ which came upon a foreclosure sale and reorganization of the Tramway Company, the issue was raised by disgruntled persons as to whether the Company really was insolvent, insisting that the value of its property was in excess of its debts. The Company had been put into the hands of a receiver who had been allowed to raise fares. "The District Court in order to fix a basis for his conclusion that the former rate of fares was confiscatory was compelled to find the value * * * the value * * * thus found * * * was largely in excess of the total amount of debts."

⁶² The bill is House No. 170, headed to apply only to gas and electric companies. At this writing it is under consideration by the committee to which it was referred. The club is a refusal of the authority to issue any new securities and of the use of eminent domain, and the abolition of the requirement that towns setting up plants buy out the local private company.

The option to be a private or a common carrier was the constitutional right protected in the Frost Case mentioned below. Whether the issuance of securities, etc. can be also a "right" will bear discussion. One of the duties of a gas or electric concern is to extend its service as demand in its franchise area requires. Has it a right correlative to the duty; and is the use of eminent domain and new financing part of the right?

Frost v. Railroad Comm. of California 271 U. S. 583 (1926); noted 6 Boston Univ. L. Rev. 259; 21 Ill. L. Rev. 380, 40 Harv. L. Rev. 131, and discussed by the writer in 41 Harv. L. Rev. at p. 300, held that California could not force an "election" to become a common carrier on a private carrier. "It is clear that any attempt to (do so) separately and substantively, must fall before the paramount authority of the Constitution. May it stand in the conditional form in which it is here made? If so, constitutional guaranties, so carefully safeguarded against direct assault, are open to destruction by the indirect but no less effective process of requiring a surrender, which, though, in form voluntary in fact lacks none of the elements of compulsion." See also "Unconstitutional Conditions and State Powers," S. C. Oppenheim (1927), 26 Mich. L. Rev., 176.

⁶³ 18 F. 2nd. 226 (C. C. A. 8th., 1927).

The question is thus neatly presented what "value" in still another sense may mean. The Court's answer adds new artificiality. After discussing the *McCardle Case*, it said that there was a "fairly clear distinction existing between value for rate making purposes, and fair, market, or actual value, and (the cases) show that the former does not necessarily bear any conclusive legal relation to the latter." It held that the value in the rate matter had no bearing on the question of insolvency. Truly, the word is a term of many ambiguities.⁶⁴

(c) PROVISION FOR FUTURE NEEDS

Beside the difficulties of discovering a working theory for a "value" for rate regulation, and of translating the "value" into a figure expressed in dollars, another word in the formula used presents thorny questions. The value sought is "the value of the property at the time it is being used for the public" as the Supreme Court put it in *Wilcox v. Consol. Gas Co.*, 212 U. S. 19, and reiterated in the *S. W. Bell Telephone Case*, 262 U. S. 276. But most of the utilities are in such service—purveying water, gas, electricity, to growing populations,—that provision for the future is a major part of their service to the community. If they today tie up money in a purchase which is a provision for later years, when does that property bought go into the "value" upon which the utility may ask the community to pay rates? The question has not always been clearly answered, nor answered in a way to be considered definitive.⁶⁵

It was up again in two cases, which concerned a gas company operating in a wide area, as to the reserve gas lands provided for future needs. The cases are *United Fuel Gas Co. v. Railroad Commission of Kentucky*, and *United Fuel Gas Co. v. Public Service Comm. of West Virginia*.⁶⁶ The former arose upon the company's suit to enjoin enforcement of an order by the Kentucky Commission fixing rates for natural gas; the West Virginia Commission's rates

⁶⁴ See R. L. Hale, "The Supreme Court's ambiguous use of 'value' in Rate Cases," 18 Colum. L. R. 208, and his "Rate making and the Revision of the property concept," 22 Colum. L. R. 209 at 209 (1922).

⁶⁵ See the discussion in *State P. U. Comm. v. Springfield Gas & Elec. Co.*, 291 Illinois 209, 125 N. E. 891 (1920) where the Court approved the foresight but said it was "not just to compel consumers to pay for more than they receive, or to pay appellee an income on property which is not actually being used to furnish gas." Judge Learned Hand, in *Consol. Gas Co. v. Newton*, 267 Fed. 231 said, "If it should appear that any plant is necessary for the reasonable future, that plant must be included as it is today, at least at its value in modern cost of reproduction."

⁶⁶ 13 Fed. 2d. 510; and 14 F. 2d. 209 respectively.

were under attack in the latter. In the Kentucky case the Court said "the real dispute is founded upon the valuation of the gas acreage."⁸⁷ It was no mean item. The Company claimed \$36,000,000 for it—the value of its property other than that for this acreage being about \$8,000,000. It arrived at the figure by estimating the gas in the ground which could be recovered and valuing it at 5c per thousand feet; the cities argued for including it merely at its cost. Just how much of the acreage was actually in use does not appear, but the Court said "it must be conceded that the Company has a right to hold, as used and useful in its business, reserve or undeveloped gas acreage, in which to prospect for gas. Much of this may prove unprofitable, but it is necessary for the continuance of the life of the business."

The Court found its guidance in the three cases of 1923 which are cited in the note 23 ante, and read the "reproduction value at such time" (of the inquiry) as "the dominant element." It said, however, that "Under these circumstances we are constrained to value the complainant's leases at the book value of \$6,732,920." What it meant by "book value" is revealed by the remark that the gas-in-the-ground theory and "the exchange value of the acreage, both ultimately involving a capitalization of earning capacity, be rejected, the only remaining evidence * * * is that of book or investment value."

In the case from West Virginia, the Court gives some separations not stated by the other tribunal. Of a total of 815,000 acres in dispute the Company is stated to be seized in fee of 42,000, and it appears from testimony which is detailed that "68,000 acres were at the time being operated." The earlier case did not attempt to separate the value of land actually used at present from that of reserve land: the only issue debated was what was the value of the whole and a value for the whole was allowed. In the case now under discussion, the question of the value of the whole was considered. The rights which had cost \$9,000,000 were carried on the books at \$40,000,000. Of this the Court said "\$31,000,000 of it represents merely the plaintiff's hope, belief or conviction, as the fact may be, that the gas properties are now worth more than five times

⁸⁷ It stated that there was "held in both productive and reserve acreage a total of 814,810 acres and the average cost of securing reserve acreage is much less than 50 cents per acre." (It was done by making a small payment for the option to search, royalties beginning only if and when, etc.).

the utmost it ever paid for them." The company's three methods of supporting its figure are set forth elaborately in engineers' estimates. "No one leaves upon the mind the conviction of certainty or finality." But in this West Virginia case the Court dismissed the question of the general valuation and undertook to differentiate for valuation purposes, the used and useful. It said, "What proportion of this is presently used and useful in the public service? Roughly four-fifths of the valuation it (the company) puts upon (the lands) is represented by gas, which, upon reasonable grounds, it believes to be under land which it has not yet operated." As to what the company paid for the reserves, the court stated "the total cost to the plaintiff of its gas rights does not amount to more than \$9,000,000." Nevertheless it concluded, "If we are right, \$10,317,311.39 is the highest valuation which can be put on such portion of plaintiff's gas reserves as it has any claim to include in its rate base."

The result of the two cases, so far, is thus: in the one, the company is held to cost, merely, but the cost of the whole provision for the future is added into the present value; in the other the whole provision for the future is not added in at all, but such proportion of it is assumed to be presently useful that its "value" arrived at by experting is a considerably larger item in the valuation than the cost. Mr. Justice Butler's language in *McCardle v. Indianapolis Water Co.*, ante, "then the present value of lands plus the present cost of constructing the plant * * * is a fair measure of the value" if taken at its face as to the land, would seem to make the first decision "wrong." In the "rightness" of the latter's theory, there is no comfort to the prudent investors and little enough for a company which might be left to carry as mere dead weight a large necessary provision for next year or next decade. In the actual decision, however, the Court sweetened the bitterness of its theory by a large liberality in the estimate of what was "used."⁶⁸ Neither company

⁶⁸ A brief note on the case in 36 Yale L. J. 279 (Dec. 1926) reviews the few cases on the general topic, and shows their reluctance to allow rates to be based on the potentially useful property.

In *Brooklyn v. Borough Gas Co. v. Prendergast, et al.* P. S. Commrs., 16 F. 2d. 615, the Court said "The Company's book cost . . . is \$175,000, and the assessed valuation . . . \$130,000. Neither of these figures reflect the real value at the time of this inquiry. . . . It has been held that land not yet in use but reasonably acquired for future use may be allowed as part of the rate base. *Consol. Gas Co. v. Newton*, D. C. 267 F. 263, *Brooklyn B. Gas Co. v. P. S. Comm.*, 17 N. Y. State Dept. Rep. 81." . . . The defendants offered no witnesses as to the value of the land. " . . . The only witness was Mr. Rac,

appears to be satisfied, however, and both cases are under consideration in the Supreme Court, as Nos. 19 and 79 on the present docket (U. S. Daily, February 8, 1928).

(d) DEPRECIATION⁶⁹

The problem of depreciation, which, it is asserted, could be the more readily handled under the prudent investment theory, is, of course, very much with us since the Supreme Court has so definitely⁷⁰ planted itself upon the cost of reproduction as the basis of valuation. It has received increasing attention from acute observers⁷¹ on the thesis, in part, at least, that its treatment may overshadow the question of which valuation theory. Depreciation frequently enters in the rate base cases in the form of a reserve designed to protect the integrity of the investment, but depreciation is so largely and inseparably a matter of guesswork,—“spot” guesswork preferred,⁷²—that either through wrong guessing or through

called on behalf of the plaintiff, who valued the property” at \$430,000. And the Court allowed a value of \$430,000.

See also: *Millville Elec. L. Co. v. Board of P. U. Commrs.*, N. J., 134 Atl. 918; *Mulligan Gas Co. v. City*, Okl., 250 Pac. 895; *City of Elkins v. P. S. Comm.*, W. Va., 135 S. E. 397, on the general topic.

⁶⁹ See a very excellent Comment in 36 Yale L. J. 123 (Nov. 1926) on “The depreciation problem in rate making.”

⁷⁰ Mr. Commissioner Eastman in the O’Fallon Case, 124 I. C. C. 1 at p. 52 finds no definitiveness in it: “That the Supreme Court has not yet reached firm ground may be gathered from a comparison of *McCardle v. Indianapolis Water Co.* with” (the three cases in 262 U. S. cited in Note No. 23 ante). Commissioner Hall, however, p. 62 finds it “the law of the land.”

⁷¹ J. C. Bonbright in “Depreciation and Valuation for Rate Control,” 27 Columbia L. R. 113, Feb. 1927, who reviews the literature of the subject, and who also writes on it in 51 Quart. J. Econ. 185 (Feb. 1927). “Depreciation in Public Utilities,” National Municipal League Monograph N. Y. 1925, pp. 112 reviewed by E. C. Goddard, 25 Mich. L. R. 344, Jan. 1927; N. T. Guernsey, “The rule as to depreciation in determining value,” 5 Tenn. L. R. 183 (1926); also the note in 36 Yale L. J. 123 mentioned ante, note Professor H. E. Riggs of the Engineering faculty at Michigan, has written on “Depreciation, a much confused term,” in 83 Railway Age 465 (Feb. 12, 1927).

⁷² In the *McCardle-Indianapolis Water Company* case, Mr. Justice Butler says, (272 U. S. 400, p. 416, 47 S. C. p. 150) of the report of Mr. Bemis, an engineer called by the City, “There is deducted approximately 25 per cent of estimated cost new to cover accrued depreciation of the property. It was not based on an inspection of the property. It was the result of a ‘straight line’ calculation based on age and the estimated or assumed useful life of perishable elements. . . . The testimony of competent valuation engineers who examined the property, and made estimates in respect of its condition is to be preferred to mere calculations based on averages and assumed probabilities. The deductions made in the city’s estimate, cannot be approved.”

In the *Columbus Gas Case*, 17 F. 2nd. 630, 635, “The inspection method is entirely proper and decidedly preferable where it can be effected, *McCardle v. Indianapolis Water Co.*” [etc.] But the question in the case was as to the depreciation on 300 miles of natural gas mains and “many miles” of service

too close shaving of rates by the regulating authorities, the company's accounting may build too little or too much reserve.

In a recent instance the Commission found it too much, and therefore proceeded to dispose of it. The case is *Board of P. U. Commrs. v. New York Tel. Co.*,⁷³ where the Commission set rates which were (p. 30) admittedly confiscatory so far as they, by themselves, were concerned. The company, however, had a depreciation reserve account of \$17,000,000—accumulated out of rates whose reasonableness are not questioned anywhere in the case—and the Commission made an order which Butler, J., who wrote the Court's opinion, described as follows: "The effect is to require that if total operating expenses deducted from revenues leaves less than a reasonable return (under the rates set) * * * there shall be deducted from the expense of depreciation in that year and added to the net earnings a sum sufficient to make up the deficiency; then by appropriate book entries the resulting shortage in depreciation expense is to be made good out of the balance in the reserve account built up in prior years."

This ingenious scheme to make the utility feed upon its own fat the Court upset. It agreed with the Commission that the company had charged excessive amounts to depreciation, but denied that revenue paid by consumers for service remained still their money. "The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. The amount, if any, remaining after (expenses) including the expense of depreciation is the company's compensation for the use of its property."

That when a utility prefers to accumulate funds rather than to disburse to stockholders, it does not thereby invite the Commission to cut its rates, is the obvious moral. But the opinion leaves questions unanswered. What was the financial history: what dividends

pipes all in the ground, and the evidence as to the whole was based on the inspection of "sixty odd samples . . . a total length of about 30 feet." The Court said "the method was not convincing nor clarifying" but it accepted a "judgment considering age element and all the evidence and circumstances surrounding the subject" of a 16 2/3% general depreciation and deducted figures arrived at by the use of the mysterious formula indicated. Where "spot" guessing will not do what else can be resorted to?

In *Idaho Power Co. v. Thompson et al.*, 19 F. 2d 547 at 567, the Court discusses the still more baffling task of reducing to figures the depreciation item which it calls "inadequacy," which impels to the scrapping of efficient plants because service demands outgrow them. It found the "straight line or percentage method" used by the Commission about all it could use. It adopted for all kinds of depreciation a round figure of \$2,000,000.

⁷³271 U. S. 23 (1926), 46 S. C. 363. The case is noted 36 Yale L. J. 123, 128, Nov. 1926.

had the concern paid? If it had actually paid good dividends, interest, etc., and also paid too much into the depreciation account, surely the case is different from that in which it simply laid by excessive amounts labelled "for depreciation." Nothing is said about the rates in force while it was doing so. The tacit assumption of the case is that they were reasonable. But were they reasonable under the possibilities unexplained?

(e) INTANGIBLES IN THE RATE BASE

Since it touched upon going value, working capital and water rights as items, the *Indianapolis Water Case* has given new impetus to the discussion of the allotment of value to the intangibles. The Company introduced estimates of the physical valuation of two groups of engineers apparently working separately, to which were added in each case an even \$500,000 for water rights and variant figures for the other items. In one \$235,000 was for working capital, and \$2,000,000 for going value; in the other material and supplies were averaged at an amount on hand of \$127,939, and cash equal to one-eighth of one year's gross earnings amounting to \$233,306 made the capital item \$361,245, while going value appeared at \$2,098,000. Thus, lump figures and detailed figures were offered for choice.

Of these items Mr. Justice Butler said, p. 412:

"For working capital, the commission's chief engineer included \$102,997 to cover materials and supplies. He did not include anything to cover cash working capital. The commission adopted his total and added \$135,000 for cash, making \$237,997 in all. The testimony of the company's witnesses supports a higher figure, and there was no other evidence on the subject. The amount is low when compared with those included in other cases.

The commission discussed the company's water rights. It said: "Petitioner has acquired and now owns the right or privilege of taking and using all the water in White river and Fall creek for the purposes incident to its business. This right is an extraordinarily valuable part of the whole value of this property. The right to use the water of White river has saved the water company and likewise the citizens of Indianapolis millions of dollars over what it would have cost to secure sufficient water for the needs of the city in any other possible way. * * * The water company is entitled to share in the benefit of this valuable possession by reason of the fact that by its foresight, ingenuity and initiative it has taken this stream of uncertain flow of impure water and has converted it into an immense asset both to itself and to the public."

The value of these water rights must be included. *San Joaquin Co. v. Stanislaus County*, 233 U. S. 454, 459.

The report further stated:

"A good property has an intangible value or going concern value over and above the value of the component parts of the physical property. * * * Any reasonable man with a knowledge of this property and the local conditions would unhesitatingly affirm that it had a value far in excess of the value of the pipe, buildings, grounds and machinery. Consider its earning power with low rates, the business it has attached, its fine public relations, its credit, the nature of the city and the certainty of large future growth, the way the property is planned and is being extended with the future needs of the city in view, its operating efficiency and standard of maintenance, its desirability as compared with similar properties in other cities and with other utilities of comparable size in this city. These things make up an element of value that is actual and not speculative. It would be considered by a buyer or seller of the property or by a buyer or seller of its securities."

The decisions of this court declare:

"That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use." *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, 165; *Denver v. Denver Union Water Co.*, 246 U. S. 178, 191, 192.

And see *National Waterworks Co. v. Kansas City*, 62 F. 853, 865, 27 L. R. A. 827; *Omaha v. Omaha Water Co.*, 218 U. S. 180, 202, 203, 48 L. R. A. (N. S.) 1084, and cases cited.

The commission January 2, 1923, in No. 6613 included \$1,416,000, being 9.5 per cent. of the amount attributed to the physical elements, to cover water rights and going value. November 28, 1923, in No. 7080, it included only \$980,000 to cover working capital, water rights and going value. There is no specification of the amount assigned to each. It stated that the amount was a smaller percentage of the value of the physical property than is usually allowed in such cases. There is nothing in the record to justify the reduction. Deducting \$135,000 for cash working capital, the amount included for water rights and going value is less than six per cent. of the value of the physical elements as fixed by it. Having regard to the character of the system, that amount is clearly too low. The valuation engineers called by the company appraised water rights and going value separately. Each fixed the value of water rights at \$500,000, and one put going value at \$2,000,000, and the other at a slightly higher figure. The commission's engineer made no appraisal of water rights or going value. The evidence is more than sufficient to sustain 9.5 per cent. for going value. And the reported cases show-

ing amounts generally included by commissions and courts to cover intangible elements of value indicate that 10 per cent. of the value of the physical elements would be low when the impressive facts reported by the commission in this case are taken into account."⁷⁴

The whole subject of going value was overhauled in an article "Going Value in rate cases in the Supreme Court,"⁷⁵ written in the light of the *McCardle Case*. The author reads the prior decisions to mean that the going value allowed for was only the costs of assembling the plant and that Mr. Justice Butler misinterpreted them. A long note, "Going Concern Value of Public Service Companies,"⁷⁶ on this aspect of the *McCardle Case* is less confident of the definiteness of the rule developed by the Federal Court and considers that the precise basis is yet to be set by that tribunal.

(f) RATE OF RETURN

The problem of the valuation of the rate base has so greatly engaged attention that the rate of return⁷⁷ has lacked discussion commensurate with its possibilities as an adjusting device. Commissioner Woodlock dissenting in the *O'Fallon Case*, accepts the variance-in-total-figures-in-dollars theory, because, he says, "The dollar is valuable only because of the commodities it will buy. Its

"This the Court read in the *Columbus Gas Case*, 17 F. 630 at 634, as follows: "The master made no allowance for going concern value . . . (stating) that under the Ohio rule announced by the Supreme Court and followed by the Public Utilities Commission, no allowance for going concern value or attaching business is made unless that value or cost has been established by direct evidence. The Court is of opinion that no such rule has been announced by the federal courts, but, on the other hand, going concern value has been a recognized element of value by the Supreme Court and inferior federal courts. Attention is directed to the following cases: *McCardle v. Indianapolis W. Co.*, 47 S. Ct. 144" [the *Des Moines Gas Case*, 238 U. S. 153, *Denver Water Case*, 246 U. S. 178, *Monroe Gas Light Case*, 11 F. 2nd 319 were also cited]. The Court added 10% for the item.

In the *Idaho Power Co. Case*, 19 F. 2nd 547, 559, the Court was more discriminating in disposing of an item for going value. The company claimed \$2,500,000 and the Commission allowed \$825,682. The Court said "as we construe these (Supreme Court) cases . . . commissions may not adopt going value in a broad indefinite sense or reject its substantial elements when they are shown to exist." It remarked that the term was "highly elastic, and at will it is used to embrace much or little." Its analysis of the items offered is too long for present insertion. It rejected mere good will, yet it arrived at "a capitalizable going value" of \$1,500,000.

⁷⁴ By E. W. Bemis, 27 *Columbia L. R.* 530, May 1927. See also an article by T. D. Summer, in 4 *Jour. Land and P. U. Econ.* 59, Feb. 1928.

⁷⁵ 11 *Minn. L. R.* 641, 54, June 1927. It is a valuable survey of the commission and judicial decisions.

⁷⁶ See "A fair return for Public Utilities," J. H. Bickley, 3 *Jour. of Land and Public Utility Economics* 61, Feb. 1927; and "Reasonable Rates of Return in Public Utility Cases," H. D. Dozier, same p. 71.

purchasing power is notoriously characterized by great and continuous instability. The investment theory of value urged by the majority equates railroad property with the dollar. The principles of valuation expressed in the decisions of the Supreme Court equates railroad property with all other forms of property. This is only real and effective stabilization. For the majority's theory to produce effective stabilization of railroad property, it would be necessary, first, to stabilize the dollar. Who is there who does not know his dollar today buys him a good deal less food, fuel, clothing and shelter than it did in 1914?" "He" has made his solution simply by getting so far as possible, more dollars of 1927 purchasing power, to meet the demands of 1927 sellers for more dollars.⁷⁸

Not less than "he," the utilities need and get, to meet operating costs, more of these 1927 dollars to buy labor and supplies in the same market. Laboring men get more wages now. Money at labor in the industry seeks similar "raises." To offer its investors 6% on \$1,000,000 now for an investment of \$1,000,000 made in 1914, when \$60,000 bought adequate "wages" to stockholders money in that year 1914, and limit them to 6% on \$1,000,000 in 1927 when 120,000 1927 dollars will not buy as much, is unpalatable indeed. That is Mr. Woodlock's point, and he reads the Supreme Court decisions to bar forcing it upon the investors.

It is not yet greatly suggested that the rate base can be left stable and the rate of return used to cover the swing of the dollar. In the *O'Fallon Case* the Commission was dealing with a fixed figure, but in other instances there is no such artificial limit; and it may be that the next phase of the rate problem will concern itself with what might be done toward securing to the utility the 120,000 1927 dollars not by doubling the multiplicand, but by doubling the multiplier, and giving a 12% return. As Professor Irving Fisher, however, points out, there are bondholders to be considered, as bonds are written, income is fixed, and on no sliding scale. There is also to be considered the public's psychological reaction to such a figure as 12%. The ingenuity of bankers in revamping the corporate structure, so lately censured by the critics, is challenged by the pres-

⁷⁸ Now to evaluate the "now" dollar against the "then" dollar has not appalled the economists, and their basis of calculation has taken into account a great range of basic commodities. Professor Irving Fisher has made index figures and has shown how the depreciated dollar affects railroad valuation, by graphs. See a copyrighted article by him on the *O'Fallon Case*, in *Boston Transcript*, June 27, 1927.

ence of the bondholders. The second consideration challenges the public intelligence no less than does the present divergent valuation doctrines. A sliding rate of return on a fixed valuation figure is not more an exploration of public intelligence than is a sliding rate of return on a sliding valuation figure.

In *McCardle v. Indianapolis Water Co.*, Mr. Justice Butler gives the "now" rate of return on a "now" valuation—thus supplying the utility investors demand for 120,000 "now" dollars. The "present rate" is the return which due process requires, but it too, and, naturally, is as much a subject of guesswork as is the rate base valuation.⁷⁹ The process is illustrated in the *McCardle Case*, where Butler, J., said, p. 419:

"The commission November 28, 1923, found 7 per cent. to be a reasonable rate of return. It stated that was the rate the city's appraiser, Mr. E. W. Bemis, testified to be reasonable. At the trial, the company introduced testimony supporting higher rates. Mr. Hagenah and Mr. Elmes testified that 8 per cent. was a reasonable rate of return. Mr. Metcalf, consulting engineer for the company, supported a rate of 7.5 per cent. to 8 per cent. Appellants offered a study by Mr. E. W. Bemis of the rates of yield to investors on certain public utility bonds. He took into account 524 flotations put out at different times between July, 1921, and February, 1924, inclusive. The average yield in the last six months of 1921 was 7.33 per cent. and in February, 1924, 6.11 per cent. The trend was not downward throughout the whole period. It was upward from the last half of 1922 through all of 1923. And he testified that there should be added .4 of 1 per cent. to cover brokerage. It is obvious that rates of yield on investments in bonds plus brokerage is substantially less than the rate of return required to constitute just compensation for the use of properties in the public service. Bonds rarely constitute the source of all the money required to finance public utilities. And investors insist on higher yields on stock than current rates of interest on bonds. Obviously, the cost of money to finance the whole enterprise is not measured by interest rates plus

⁷⁹ *Bluefields Water Works Co. v. Pub. Serv. Comm.*, 262 U. S. 679 (1923), 692, "What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment having regard to all the facts" . . . "equal to that generally being made at the same time and in the same general part of the country, on investments in other business undertakings which are attended by corresponding risks and uncertainties" . . . "reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management to maintain and support its credit." . . . "A rate of return may be reasonable at one time and become too high or low by changes affecting opportunities for investment, the money market and business generally"; all these formulas are in the same opinion.

brokerage on bonds floated for only a part of the investment. The evidence is more than sufficient to sustain the rate of 7 per cent. found by the commission. And recent decisions support a higher rate of return."

This rate is not greatly different from the rate in pre-war cases. In the latter, 6% was a favorite figure and the cases after a post-war raise to as much as 8% are working back to it.⁸⁰

IN CONCLUSION

In conclusion, a reflection or two on our national attitude toward the man who has investible funds may not be inappropriate. Since the World War we have become what England was in the nineteenth century—a nation of exporters of capital. The figures are stated at \$2,000,000,000 per annum in recent years; and the total, to date, at \$15,000,000,000. This money goes to the upbuilding of foreign countries, and only time can tell what protection the United States may be called upon to give to the investment.

Undoubtedly the 120,000,000 people of the United States are going to spend money in their own territory to make it more habitable for themselves, and much of the increased habitableness will be in the hands of the public utility enterprises. Statesmanship in economics—and no less in international politics—would seem to call for a policy of rewarding the utility investor at home sufficiently to lessen the urge to foreign investment which is speculative at best. To the writer the present attitude of the 120,000,000 takes no apparent account of this money export, a new factor in our history and one to be reckoned with as a background in any discussion, hereafter, of making domestic investment attractive.

⁸⁰ See J. E. Kirschman, "The Principle of Competitive Cost in Public Utility Valuation," 35 Yale L. J. 805 (1926) for his view of this matter. Six percent was held to be too low in the Bluefields Water Case, *supra*, in the Supreme Court in 1923; seven was not confiscatory in the Columbus Gas Case, 17 F. 2d 630, and in the Idaho Power Case, 19 F. 2d 547. The discrepancy between the original 5¼% for the railroads under the Recapture Act, and the other rates and the discrepancy between the latter 6% for the roads and the 7% in the Indianapolis Case has not escaped comment. It is pointed out in "The Index" published by the New York Trust Company. (Boston Transcript, Jan. 25, 1927).